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FM AMEMBASSY RIGA
TO RUEHC/SECSTATE WASHDC PRIORITY 5983
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE PRIORITY
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 02 RIGA 000413

SIPDIS

E.O. 12958: DECL: 08/06/2019
TAGS: [EFIN](#) [PGOV](#) [ECON](#) [PINR](#) [LG](#)
SUBJECT: PAREX BANK: NO SMOKING GUN, CALLS FOR FURTHER
INVESTIGATION (C-TN9-01445)

REF: A. A) STATE 68184
[B. B\) 08 RIGA 723](#)
[C. C\) 08 RIGA 701](#)
[D. D\) 08 RIGA 690](#)

Classified By: Charge d'Affaires Bruce Rogers for Reasons 1.4 b & d.

[1. \(C\) Summary:](#) This cable provides an update on the condition and future direction of Parex Bank and responds to questions from Ref A. The deal to nationalize Parex Bank and the circumstances surrounding its collapse continue to spark controversy in Latvia, including calls by the GOL for a formal investigation of the deal as well as Parex's activities prior to its collapse. Audits of Parex Bank indicate that it may have understated losses in its reports prior to the bank's takeover by the GOL. Former shareholders made some moves immediately before being removed that they clearly continue to profit from. There are no indications yet of patterns of further suspicious activity prior to the collapse on the part of Parex or its customers. However, there are still many unanswered questions about the bank and the takeover. Public officials are primarily focused on investigating the decisions made by the previous government rather than investigating the bank's activities or planning for any future problems in the banking sector. For their part, Parex has plans to split into two entities and rebrand to make themselves more attractive to prospective buyers. End Summary.

[2. \(U\) In late 2008, Parex Bank faced a severe liquidity problem, forcing a government takeover. In November, the GOL purchased a 51% share in Parex for two lats \(US \\$4\), in order to avoid a bank collapse and the associated and unaffordable payouts of government-insured deposits. Subsequently, as the negotiations for an IMF bailout package began, the GOL completed a full nationalization of the bank, removing the prior shareholders, Valery Kargins and Viktor Krasovickis, from the board. Accusations that the bailout was more in the interests of the previous shareholders than of the Latvian public persist. \(Refs B, C, and D.\)](#)

What Audits Have Uncovered - so far

[3. \(SBU\) Independent audits have not uncovered any problems in Parex's books that directly indicate fraud, malfeasance, or alarming patterns of customer activity. That said, there is much that remains unclear, and illicit activity may yet be uncovered. There are some unexplained losses and discrepancies between audits and annual reports, and the situation remains murky even for close observers. \(The U.S. Treasury sent an expert advisor to assist with the audit process, but she came out of the process with more questions than answers.\) There were certainly problems with Parex's business model that closer supervision may have prevented, although this is far from unique to Parex or Latvia.](#)

[4. \(SBU\) There were external audits before and after the government takeover. Ernst and Young conducted a regular](#)

audit just prior to the government takeover, and Price Waterhouse Coopers (PwC) conducted another just after. There is no proof of irregularities in these audits, but there are reasons for closer investigation. Ernst and Young had conducted the previous seven audits of Parex, and though rotation of auditors may have been advisable, this did not violate any formal accounting standards. PwC conducted audits just after the takeover and indicated that as of November, 2008, loan losses at Parex were understated by 71M LVL (US \$142M).

15. (C) Like many banks, Parex was highly exposed to the real estate market and used short-term measures to finance long-term assets. The outflow of deposits Parex experienced included both Latvian and non-resident deposits and was common to several banks in Latvia. However, Parex also relied heavily on a small number of major non-resident depositors, and the bank had unusually high operations costs.

Roberts Stugis, Parex CFO and a bank employee since its inception, claimed these high operations costs were due to loyalty to employees and a sense of complacency about the bank's success that led to inadequate cost controls. Outside observers, such as State Auditor Inguna Sudraba, suggest that Kargins and Krasovickis were paying for substantial private expenses with bank money, and would call their "loyalty" to employees simple cronyism.

Calls for Investigation

16. (C) Finance Minister Einars Repse has called for an investigation on the takeover, which briefly but noticeably

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sent deposits fleeing again. For her part, Sudraba is working to develop enough evidence to call for a criminal investigation. This may be pushing the traditional role of a State Auditor's office, but she is one of the few public figures in Latvia with enough public trust to do it. Sudraba argues that it is clear from the publicly available facts that the government was acting to protect the interests of previous shareholders, not to protect the interests of the public.

17. (C) Accusations directed at Kargins and Krasovickis do not allege a lack of cooperation with a government takeover, but rather their enthusiastic willingness to work on a deal that was highly beneficial to them - selling a bank with huge liabilities for two lats was a sweet deal. Questions remain about their liability for the bank's debts. While they transferred many assets to friends or family before the takeover, they continue to earn an estimated 200,000 LVL (US \$400,000) each month on interest from their accounts at Parex, for which interest rates were increased just before their departure. Sudraba sees this as their "golden parachute" deal as they left the bank. Stugis, their former employee at Parex, argues that while they are certainly living comfortably, they are so tainted by the Parex scandal that they cannot undertake any other business ventures.

Future Plans for Parex

18. (SBU) Parex does plan to change its business model significantly. They intend to split their two lines of business - retail banking and wealth management. They hope that each part on its own will attract an investor, since there has been little interest in the combined package. Stugis said that there was interest in purchasing portions of the bank before the takeover, but Kargins and Krasovickis were only interested in selling it all as one package - a package they over-valued compared to offers they received. In the meantime, EBRD has agreed to take over a 25% stake in the bank, which may help confidence. Kaspars Abolins, the State Treasurer and a Parex board member, indicated that a re-branding to shed the Parex name was coming soon. Debate

about whether it is better for the GOL to unload Parex soon or wait and try to get a better price later is a popular topic lately, with the proponents of waiting currently holding the upper hand.

¶9. (U) Parex is still looking for a buyer for LP Anlage und Privatbank, which is self-funding and is not a major factor in Parex's overall finances. Latvijas Krajbanka remains one potential buyer. The exclusive agreement giving Krajbanka the option to buy Anlage has expired and has not been renewed.

¶10. (C) Irena Krumane, head of the Financial and Capital Markets Committee, reports that no other banks appear to be troubled, although all are reporting significant losses. Close Parex competitor Rietumu Bank is perhaps the only bank in Latvia that reported a profit in their most recent report. Parex chief Nils Melngailis argues that this was evidence of Parex's honesty, in that it has been reporting its losses for months now. Melngailis is a U.S. citizen and former director of the Latvian national phone company, Latelekom, and has long been a trusted contact of the Embassy. Regulators are careful not to say anything too harsh about current Parex management, but they are clearly concerned - probably more about their capabilities as managers rather than their honesty. Other members of the management team are holdovers from before the takeover, and may hold continued loyalty to the previous owners.

¶11. (C) Comment: It is no surprise that Kargins and Krasovickis made out very well in the takeover. Calls for further investigation of Parex make good political theater, but their usefulness may be limited. It seems unlikely that any serious investigation of any ethical or legal violations will take place. On the other hand, the eccentric but economically savvy Finance Minister managed to drive down the value of the (now GOL-owned) bank with what seem like politically motivated calls for an investigation just as the government is trying to sell. The State Auditor remains the only potential honest broker, but her office appears outmatched in terms of financial sophistication and her office was never intended to conduct this kind of investigation.
ROGERS